

# ***Research on the Identification of Value in Corporate Bankruptcy Reorganization***

**Jinhua Lin<sup>1,a,\*</sup>**

<sup>1</sup>*Jiangxi University of Science and Technology, 86 Hongqi Avenue, Zhanggong District, Ganzhou City, Jiangxi Province, China*

*a. 2899298674@qq.com*

*\*corresponding author*

**Abstract:** Bankruptcy reorganization, as a crucial procedure for corporate regeneration and debt resolution, plays a significant role in the salvation of enterprises and the resolution of debts. The identification of the value in corporate bankruptcy reorganization is an extremely important prerequisite, as it is closely related to the initiation of the reorganization process, the smooth progress of the reorganization, and the ultimate success of the reorganization. From the current judicial perspective, China's "Enterprise Bankruptcy Law" does not provide explicit regulations on the identification of the value in corporate bankruptcy reorganization. This lack of clarity hampers the ability of various levels of people's courts and bankruptcy administrators to address relevant issues in practice, thereby impeding the effective protection of the interests of corporate debtors and creditors. Therefore, improving the identification of the value in corporate bankruptcy reorganization holds significant practical and guiding significance.

**Keywords:** Enterprise, Reorganization Value, Identification

## **1. Introduction**

In recent years, the growth pattern of China's socialist market economy has shifted towards high-quality development. The rapidly changing market demands have triggered intense market competition, leading many enterprises to face challenges such as poor management and financial difficulties. Ultimately, these challenges put these enterprises at risk of exiting the market. The First Session of the Thirteenth National People's Congress emphasized the need to continue eliminating ineffective supply, adhere to market-oriented and legal means to resolve overcapacity, eliminate outdated production capacity, and legally clean up "zombie enterprises," including those that can continue to create vitality for China's market economy [1]. The establishment of the bankruptcy reorganization system is precisely to rescue these troubled enterprises, help them regain new life, and return to the market. However, not all enterprises facing operational difficulties have the possibility of self-rescue through the bankruptcy reorganization system. Bankruptcy reorganization is not a system that can be freely chosen; it is a procedure that can only be entered after approval by the people's court. Only enterprises with reorganizational value are eligible to enter the bankruptcy reorganization process, which is a prerequisite for troubled enterprises to initiate bankruptcy reorganization proceedings. However, there is currently no clear and specific provision in China on how to identify reorganizational value.

In accordance with the provisions of Article 2 and Article 70 of the “Enterprise Bankruptcy Law” of China, entities eligible to submit applications for bankruptcy reorganization to the People’s Court include debtors, creditors, and contributors in enterprises undergoing bankruptcy liquidation but not yet declared bankrupt, with their contributions accounting for more than one-tenth of the debtor’s registered capital. However, this regulation merely clarifies the establishment of China’s bankruptcy reorganization system and the entities eligible to apply for bankruptcy reorganization. It does not explicitly specify the conditions for enterprises facing operational difficulties in China to initiate and enter the bankruptcy reorganization process.

On March 4, 2018, the Supreme People’s Court issued the “Minutes of the National Court Bankruptcy Trial Work Conference,” in which Article 14 explicitly states, “The objects of bankruptcy reorganization should be troubled enterprises with salvage value and potential. For zombie enterprises, market clearance should be promptly achieved through bankruptcy liquidation. When the people’s court examines reorganization applications, if, based on factors such as the debtor’s asset condition, technological processes, production and sales, and industry prospects, it can be determined that the debtor clearly lacks reorganizational value and salvage potential, the court should decide not to accept the application” [2]. This article provides a framework for the conditions under which enterprises can enter bankruptcy reorganization, offering practical guidance to people’s courts at all levels. However, it lacks specific standards. Thus, the identification of reorganizational value should be considered a top priority, as its neglect could lead to the misuse of judicial resources.

## **2. Challenges in Identifying the Value of Bankruptcy Reorganization**

### **2.1. Lack of Professional Expertise for Assessment**

Determining the value of bankruptcy reorganization is a business judgment that should be provided with comprehensive guidance by professionals possessing relevant expertise. This decision should not be made by non-market professionals such as the people’s court or bankruptcy administrators, as it may lead to uncertainty in value identification. The assessment of a company’s value is a critical decision that accompanies certain business risks and should be made by professionals with the necessary knowledge.

### **2.2. Lack of Theoretical Guidance for Value Assessment**

The value assessment of corporate bankruptcy reorganization holds significant importance for both legal and financial applications. This assessment is based on the market value of the effective assets owned by the company. Through the application of various methods and means, it predicts and estimates the reorganization potential of the company, clarifying how the bankrupt entity should choose the bankruptcy procedure under its own operational circumstances. Assessing the reorganization value of bankrupt companies not only provides an analytical framework for stakeholders such as creditors and the court regarding the debtor’s reorganization potential but also offers necessary technical support, operational procedures, and information system support for third-party intermediaries. In China, bankruptcy reorganization poses a significant challenge and problem for both the legal and financial sectors. The successful assessment of the reorganization value of bankrupt companies requires collaborative support from various disciplines such as law, economics, management, finance, and accounting. Only through this interdisciplinary collaboration can we establish a comprehensive theoretical framework for the assessment of bankruptcy reorganization value, achieving the ambitious goal of coordinated legal and financial operations.

### **3. Significance of Identifying the Value of Bankruptcy Reorganization**

#### **3.1. Concentration of Judicial Resources, Full Utilization of Bankruptcy Rescue Function**

For a long time, due to inadequate positioning and understanding of the reorganization system's value, there has been a lack of effective identification of the value of corporate reorganization when accepting reorganization applications. This has led to a large number of enterprises without reorganizational value entering the reorganization process, ultimately resulting in failed reorganization and transition to liquidation. This process has wasted a significant amount of judicial resources, impacting the timely realization of creditors' rights. Strengthening and standardizing the identification of the reorganization value of bankrupt enterprises, allowing enterprises without reorganizational value to enter liquidation proceedings early, and enabling enterprises with reorganizational value to enter the reorganization process in an organized manner, will effectively save judicial resources. It will also concentrate judicial resources to help companies overcome difficulties, fully realizing the rescue function of bankruptcy.

#### **3.2. Strengthening Barriers to Prevent Abuse of Bankruptcy Reorganization System**

The essence of the bankruptcy reorganization system should be to protect China's troubled enterprises rather than allowing entrepreneurs to use the bankruptcy reorganization system to evade or delay debts. According to Article 40 of the "Enterprise Bankruptcy Law," "claims with interest shall cease to accrue interest from the acceptance of the bankruptcy application." If a creditor needs to declare interest, it can only be calculated up to the date when the people's court accepts the enterprise's bankruptcy reorganization application. According to Article 79 of the "Enterprise Bankruptcy Law," "the debtor or the administrator shall submit a draft reorganization plan to the people's court and the creditors' meeting within six months from the date of the people's court's ruling on the debtor's reorganization. Upon the debtor's or administrator's request and with justifiable reasons, the people's court may order an extension of three months." This provision allows the submission of the reorganization plan draft no later than nine months from the date of accepting the bankruptcy reorganization. This will result in creditors losing nine months of interest and provide the debtor with a more extended period for debt repayment during the reorganization plan execution process [3].

#### **3.3. Optimize Risk Disposal, Ensure the Effective Continuation of High-Quality Enterprises**

The rapid changes in both domestic and international markets, coupled with fluctuations in the economic and trade investment landscape, have led some enterprises to face operational and debt challenges. However, among them, certain enterprises still exhibit recoverable operational conditions and repayment capabilities. Strengthening and standardizing the identification of reorganizational value for bankrupt enterprises, actively guiding those with ongoing operational value to smoothly and efficiently enter the reorganization process, formulating rational reorganization plans, legally resolving debt crises, and providing support and assistance to enterprises are essential. This approach contributes significantly to the comprehensive restoration of economic and social order, supports the fulfillment of the "six guarantees" and "six stabilities," and serves the important values and significance of facilitating high-quality economic development.

### **4. Criteria for Identifying the Value of Bankruptcy Reorganization**

#### **4.1. Industry Position**

The industry position necessitates a comprehensive analysis of the enterprise's competitive advantages. An enterprise's competitive advantage stems from various aspects of its value chain, such

as the credit limits of upstream suppliers, the credit limits within the financial system, investors' confidence in the business prospects, trust and recognition of the management team, the degree of differentiation in the enterprise's products, cost control capabilities, a proficient marketing team, the ability to realize profit levels, and profit barriers. If a bankrupt enterprise exhibits outstanding characteristics in several of these aspects, its reorganizational value will be high, and the likelihood of successful reorganization will also be relatively elevated.

#### 4.2. Industry Prospects

Industry prospects are specifically manifested when the industry in which the enterprise operates has market recognition, advanced production capacity, or is in a thriving sector, such as new energy enterprises strongly supported by the country. Investors' interest will be more significant, and local governments will provide more support. If the enterprise operates in a declining industry or if the entire industry has entered a mature market with few new growth points, it will affect the reorganizational value of the enterprise.

#### 4.3. Operational Status

The organizational structure of an enterprise constitutes its fundamental framework and is a pillar upon which the enterprise relies for normal operation and development. The power structure within the enterprise is crucial in this regard. Whether the shareholder (general) meeting, the board of directors, and the supervisory board can maintain normal operation, whether they can convene relevant meetings periodically as required by law and make effective resolutions (decisions), and whether the senior management can faithfully fulfill their responsibilities, effectively manage the enterprise, and maintain its normal operations are all core factors when considering whether to initiate bankruptcy reorganization for the enterprise. If, within a certain period, the enterprise is unable to convene shareholder (general) meetings, board of directors meetings, and supervisory board meetings, or if these governing bodies cannot make effective resolutions (decisions) as required by law (usually within a two-year timeframe, referring to Article 1 of the Judicial Interpretation II of the Company Law), or if the board of directors has been embroiled in a prolonged dispute that cannot be resolved through the shareholder (general) meeting, it signifies that the operational management of the enterprise is facing serious challenges and issues. The organizational structure of the enterprise is essentially in a paralyzed state, lacking a clear direction forward, and is unable to conduct normal market economic activities. For such distressed enterprises, if reorganization is to be considered, it usually requires the restoration of the normal operation of various institutions. However, this inevitably consumes more time, resources, and effort, to some extent increasing the difficulty of reorganization while reducing its potential value. In addition to the organizational structure of the enterprise, the clarity of the equity structure and the presence of historical legacy issues are also critical factors to consider. If the equity structure of the enterprise is complex and unclear, or if there are internal disputes among shareholders that cannot be resolved, this will significantly increase the complexity and difficulty of the reorganization.

#### 4.4. Asset Value

The fundamental reason for an enterprise choosing the bankruptcy procedure lies in its assets. The premise for an enterprise to undergo bankruptcy reorganization is that the actual asset value obtained through the bankruptcy reorganization process must be greater than the actual asset value obtained directly through the bankruptcy liquidation process. If the post-reorganization asset value cannot cover the purpose of mitigating bankruptcy liquidation losses, the bankruptcy reorganization of such an enterprise becomes meaningless, wasting the time of all involved parties and adversely affecting

the interests of creditors. The liability situation of an enterprise can clearly reflect its current financial and operational condition. If an enterprise has a relatively low debt burden, a small amount of external guarantees, or the possibility of debt-to-equity conversion, then from the perspective of due diligence, the chances of the enterprise overcoming difficulties and achieving a rebirth are greater. Thus, the actual asset situation of an enterprise largely determines whether it has sufficient liquidity and the opportunity for a rebirth. In addition, certain industries, such as franchising, may have high operational value based on their operating qualifications, which themselves are significant assets. For enterprises possessing such qualifications, they can generate cash flow by selling or transferring these qualifications, making them more attractive to potential strategic investors. Moreover, in the context of China's listing environment, the "shell" resources of listed companies are also valuable assets that can be monetized. Underperforming listed companies may consider selling or restructuring their equity structure to obtain more cash flow or financial benefits [4]. For distressed enterprises possessing these valuable assets, their challenges may arise primarily due to a lack of funds, and once they secure sufficient capital, these qualifications and resources can automatically generate benefits.

#### **4.5. Brand Value**

With the rapid development of China's economy, many enterprises have grown larger and stronger over time. Leveraging the superiority of their products, they have established a good reputation in the industry, enjoying high goodwill and credibility, thereby possessing considerable brand value. When encountering operational difficulties, such enterprises can use these advantages for bankruptcy reorganization, successfully overcoming challenges.

#### **4.6. Social Value**

In judicial practice, the scope of debtor enterprises is highly extensive, covering a wide range of entities, including small-scale, low-employment, and low-social-impact micro-enterprises, as well as large-scale, high-employment, and high-social-impact entities like large enterprises, publicly traded companies, and financial institutions. These market entities encompass various sectors, from those involved in public utilities like water, electricity, and gas supply to financial institutions providing services for financial stability. These entities have already established a certain level of influence in their respective regions or industries. When assessing whether these market entities possess restructuring value, considerations extend beyond economic indicators. It is essential to take into account the public value to society after the successful restructuring of debtor enterprises, particularly when debtors exit the market, as it may potentially have adverse effects on the local area or industry. This consideration holds particular significance for special market entities such as state-owned enterprises, as they typically bear specific social responsibilities, and relevant regulatory authorities actively participate in the evaluation of restructuring value. It is crucial to note that these market entities differ from so-called "zombie enterprises." Zombie enterprises typically refer to state-owned enterprises that have long relied on government financial support, have lost their operational capabilities, and are unable to regenerate. The continued existence of zombie enterprises can lead to various adverse effects on the socio-economic landscape, including the idle use of industrial land and factories, resulting in the wastage of local government financial resources.

### **5. Recommendations for Improving Bankruptcy Reorganization Value Recognition**

#### **5.1. Improve the Mechanism of Coordination Between Government and Courts**

The recognition of bankruptcy reorganization value is a systematic project involving various aspects of a company's operation. As the judiciary, the court may not be familiar with the economic operations



and specific conditions of enterprises. Therefore, it is necessary to leverage the strength of government departments. This can be achieved through the form of the court sending letters to relevant functional departments to gather information, and these departments should promptly respond to the court's inquiries. During the review stage, the court can also organize hearings, inviting personnel from relevant functional departments to participate jointly in discussions regarding whether a bankrupt enterprise has reorganization value.

## **5.2. Establish and Improve Unified Standards**

The key to determining whether a bankrupt enterprise can continue to exist lies in its ability to undergo reorganization. The evaluation of reorganization capability needs to consider the comparison between liquidation value and operational value, as well as other factors. According to current bankruptcy regulations, debtor enterprises usually need to submit a reorganization application to the court, and the court ultimately decides whether to allow the reorganization. In this process, debtor enterprises often need to state information such as the reasons for bankruptcy and reorganization plans in their applications. However, whether the statements made by debtor enterprises in their applications are objective and whether they have reorganization value are often challenging for creditors and the court to determine. Therefore, subjective judgments play a significant role in the decision. This implies that both creditors and the court often lack objective criteria when assessing whether the reorganization value of debtor enterprises is greater than the liquidation value [5]. Therefore, in improving unified valuation standards, the court can introduce third-party professional organizations and experts. Entrust them to establish a standardized recognition system for reorganization value, starting from various dimensions of recognition standards, and create evaluation models to ensure the accuracy and uniformity of reorganization value recognition during the adjudication of bankruptcy reorganization cases.

## **5.3. Strengthen Training for Legal Personnel**

The adjudication of bankruptcy cases is a systematic endeavor, requiring legal personnel including judges, judicial assistants, clerks, etc., to possess strong expertise, especially in the context of bankruptcy reorganization cases. Therefore, the court should conduct regular and systematic training for legal personnel involved in bankruptcy cases to enhance their professional qualifications.

## **5.4. Reasonable Application of the Hearing System**

As a judicial body, the court lacks business judgment in identifying reorganization value and cannot form professional opinions. Therefore, the reasonable application of the hearing system is crucial for reorganization value identification. The court can introduce third-party professional organizations and experts to conduct hearings after accepting reorganization cases. Even though establishing unified standards is desirable, the unique characteristics of each case may hinder the complete application of these standards. Holding hearings with professional experts can effectively address this issue.

## **6. Conclusion**

The rapidly changing market challenges demand businesses to have a more insightful perspective. However, most companies face various operational issues. The establishment of the bankruptcy reorganization system aims to rescue these struggling enterprises. Before entering the bankruptcy reorganization process, a systematic evaluation of the reorganization value of distressed enterprises should be conducted to prevent the excessive waste of judicial resources. This paper elaborates on various standards for identifying the reorganization value of enterprises and analyzes the significance

of such identification. It provides specific recommendations on how to conduct this identification, with the aim of constructing a more comprehensive bankruptcy reorganization system that achieves the dual goals of “rescue” and “rebirth.”

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